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In The
Supreme Court of The United States
October Term 1994

KATHRYN THOMPSON REMMEY and ERNEST M. REMMEY, Executors of the Estate of LOUISE REMMEY, Deceased,
Petitioners,

v.

PAINEWEBBER INCORPORATED and ARNOLD MARKS,
Respondents.

Petition For A Writ Of Certiorari To The United States Court of Appeals For The Fourth Circuit

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REPLY BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES.....ii

INTRODUCTION..... 1

CLAIMS AS TO JOHNSON..... 1

CLAIMS AS TO LEWIS AND SCHWIMMER..... 7

RESPONDENTS' DISCUSSION ON THE MERITS.11

A. Respondents' Arguments As to Mrs. Remmey's Competence.....12

B. Delivery of Prospectuses.....14

C. Damages to the Account.....15

CONCLUSION.....19

TABLE OF AUTHORITIES

CASES:

Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) 4

Commonwealth Coatings Corp. v. Continental Cas. Co., 393 U.S. 145 (1968) 6, 7

Gen. Warehouseman & Helpers Local 767 v. Standard Brands, Inc., 579 F.2d 1282 (5th Cir. 1978), cert. den. 441 U.S. 957 (1979 15

Middlesex Mut. Ins. Co. v. Levine, 675 F.2d 1197 (11th Cir. 1982) 4

Miley v. Oppenheimer, 637 F.2d 318 (5th Cir. 1981) 17

Rogers, Att'y Gen. v. Schering Corp., 165 F. Supp. 295 (D.N.J. 1958), mot. den. 262 F.2d 180 (3d Cir. 1959), aff'd 271 F.2d 266 (3d Cir. 1959), cert. den. 359 U.S. 991 (1959) 4

SEC v. Prudential Securities, Inc., 1993 CCH Fed. Sec. L. Rep. Transfer Binding ¶ 97,780 18

Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987) 19

OTHER AUTHORITIES:

9 U.S.C. § 10(a) 1

9 U.S.C. § 10(a)(1) 1, 8

9 U.S.C. § 10(a)(3) 1, 2

9 U.S.C. § 10(b)(2) 1

15 U.S.C. § 77e 14

NASD Code of Arbitration Procedure § 19(c)5 ..... 8, 11

NASD Code of Arbitration Procedure § 22 2

NASD Rules of Fair Practice 13

INTRODUCTION

Respondents suggest a lack of specificity in the Petition for Certiorari as to the grounds set forth in 9 U.S.C. § 10(a) on which petitioners claim this arbitration should be vacated. If the Petition is in any way deficient in this regard we gladly supply various grounds.[1]

CLAIMS AS TO JOHNSON

As to Johnson, who falsified the application by which he became an arbitrator, the grounds are easy: "Corruption, fraud or undue means" pursuant to § 10(a)(1), "evident partiality or corruption" pursuant to § 10(b)(2), or, in particular, "misconduct" by which the "rights of any party have been prejudiced" pursuant to § 10(a)(3).

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[1] Respondents have cited to portions of the Joint Appendix in the Fourth Circuit using JA as an abbreviation. We will do likewise herein. Otherwise, any references will be to the Appendix in this Court, using the abbreviation A.

Respondents urge upon this Court a denial of certiorari, which, under the Fourth Circuit opinion, means that a deliberate false statement by an arbitrator (JA 274) which deprives a party of her right, clearly specified under the NASD rules, to challenge an arbitrator peremptorily, is not arbitrator misconduct under § 10(a)(3). Apparently, so far as the Fourth Circuit is concerned, in today's permissive society an untruth is no longer misconduct.

It cannot be argued that petitioner did not have, under NASD's Code of Arbitration Procedure, § 22 (A 69), the right to a peremptory challenge to any one of the arbitrators. Nor can it be argued that the information as to Johnson's ethical violations was not material to someone deciding whether to assert a challenge. Respondents' arguments that

Johnson's violations were not serious miss the mark. The Fourth Circuit has already held that Johnson's ethical violations were material. See Petition, p. 20.[2] But in holding that the violations did not prove bias, the Fourth Circuit also missed the point. Mrs. Remmey was deprived of material information relating to her right to challenge the arbitrator regardless of whether the information did or did not establish bias. She and her counsel had the right to decide for themselves whether they believed Johnson might be biased

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[2] Respondents are mistaken in arguing, Brief in Opposition, p. 10, that the 1978 ethical violations referred to in the Petition, p. 9 were against Johnson's firm only. This is incorrect. All the violations referred to in the Petition, and the fines of $1,000 and $500, were against both Johnson and his firm (McDaniel Lewis & Company), jointly and severally. Thus, there were six findings of ethical violations against Johnson at the time he swore there were none in his application to be appointed an NASD arbitrator. JA 279-92.

because of his violations and thereby to decide whether to challenge him or not. See Middlesex Mut. Ins. Co. v. Levine, 675 F.2d 1197 (11th Cir. 1982); Rogers, Att'y Gen. v. Schering Corp., 165 F.Supp. 295 (D.N.J. 1958), mot. den. 262 F.2d 180, (3d Cir. 1959), aff'd 271 F.2d 266 (3d Cir. 1959), cert. den. 359 U.S. 991 (1959).

Respondents purport not to understand the meaning of Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972), discussed in the Petition. While Affiliated Ute was a securities case, its holding that failure to disclose material information establishes a presumption of causation in fact is universal. The law does not require a party to prove a negative or hypothesize about what withheld material information would have proved. As Affiliated Ute states at pp. 153-54:

> [P]ositive proof of reliance is not a prerequisite to recovery. All that is necessary [for recovery] is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. (Citations omitted). This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact.

Clearly, any party to an arbitration would have considered the information as to Johnson important on the decision whether to challenge him as an arbitrator.

But the Fourth Circuit not only ignored this withholding of material information from Mrs. Remmey. Its opinion goes much further and holds that in order to establish an impermissible award Mrs. Remmey had to show that Johnson's infractions actually "affected Johnson's impartiality ...." A 16. Contrary to respondents' arguments, the other federal circuits make no such requirement that an

effect on impartiality be proved. The other circuits hold that it is sufficient to show facts which constitute a "reasonable impression" of bias, a far different standard than one which requires actual proof of bias. See Petition, pp. 17-18. Since bias is subjective, the Fourth Circuit standard is impossible to meet.

Beyond that, respondents would tell this Court, and the Fourth Circuit seems to hold, that the only way even to show a "reasonable impression" of bias is by showing a financial or personal relationship by an arbitrator with a party. We know of no other federal circuits which have so held, and certainly, whatever its facts, that is not the meaning of Commonwealth Coatings Corp. v. Continental Cas. Co., 393 U.S. 145 (1968), which abhors even "an impression

of possible bias" and requires "strict morality and fairness ... on the part of the arbitrator," 393 U.S. at 148.

Respondents argue that the NASD had the information about Johnson's ethical violations. It is certainly true that another division of the NASD had the information. If NASD withheld the information deliberately, that worsens the injustice here. But if NASD was, itself, fooled by Johnson's false application, to put the burden on a party to find out information which NASD didn't bother to find in its files places an absurd burden on claimants in arbitration and destroys arbitration as an efficient process.

CLAIMS AS TO LEWIS AND SCHWIMMER

Respondents are correct that the use of these two individuals as arbitrators constitutes an arbitral award "procured by

... undue means. 9 U.S.C. § 10(a)(1). (Brief in Opposition, pp. 6-7). The rules of NASD are specific. Under NASD Code § 19(c)(5), A 67, the NASD is required to exclude from an arbitration panel any "professional who has devoted twenty (20) percent or more of his or her professional work effort to securities industry clients within the last two years." This rule was adopted because of concerns by this Court and SEC. A 83. Respondents do not argue that NASD ever determined that Lewis and Schwimmer did less than 20% of their work effort for industry clients. Their argument is that petitioner didn't prove that Lewis and Schwimmer were not qualified. But the burden of proof upon petitioners, if any, was no more than to show that these arbitrators had not been duly qualified in accordance with NASD's rules. That was clearly shown. The

purported contract signed by Mrs. Remmey contracted for arbitrators appointed in accordance with the rules of NASD. A 92. If NASD did not appoint arbitrators whom it had qualified according to its own rules, Mrs. Remmey was deprived of her contractual rights and any arbitral decision by such arbitrators was indeed obtained by "undue means" and in violation of Mrs. Remmey's rights of due process.

Defendants argue that the director of arbitration for NASD filed an affidavit with the district court which stated that the lack of a completed sworn questionnaire update did not disqualify a person as a public arbitrator.[3] JA 366.

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[3] This affidavit also made clear that the Arbitrator Profile Questionnaire update, which should have been immediately returned by Schwimmer and Lewis, was forwarded to them on March 26, 1990, and that even to the date of the director's affidavit, January 29, 1993, almost three years later, neither Schwimmer nor Lewis had ever returned it.

The director of arbitration cited no rule supporting this position in her self-serving affidavit, obviously signed at respondents' request for purposes of this case. It is hard to give credence to such a statement in the face of the same director's memorandum which stated that NASD's data base upon which it qualifies arbitrators "requires"

> additional information which will assist us in classifying arbitrators as securities or public arbitrators in accordance with the provisions of the new rules. (Emphasis supplied). A 86.

Respondents also seek to excuse the lack of anything in NASD's files which could establish Schwimmer's credentials at any time. Again, respondents argue the self-serving affidavit by NASD's director of arbitration to the effect that Schwimmer had been approved prior to NASD's utilization of either the

arbitrator questionnaire or the arbitrator profile update, and this made it appropriate for NASD to appoint Schwimmer as an arbitrator. How can this be, particularly since new rules for arbitrator appointment had been adopted by NASD because of SEC and the Supreme Court pressure? Apparently for NASD its own amended Code of Arbitration Procedure rules, such as § 19(c)(5), are followed only if NASD feels like it. What clearer evidence of sloppy failure to accord Mrs. Remmey due process of law need be cited.

RESPONDENTS' DISCUSSION ON THE MERITS

At pages 2-4 of the Brief in Opposition respondents make certain arguments which seek to convince, by implication, that respondents had justification for what was done to Mrs. Remmey's estate, and that petitioners' attack on the arbitrators here is only

sour grapes because the arbitrators ruled against petitioner. In truth, the decision by the arbitrators was outrageous, as the record below demonstrates, but because, as respondents argue, judicial review of the merits of an arbitration award is narrow, petitioners necessarily are concentrating in this Court on clear violations of Mrs. Remmey's procedural rights as to which there can be no argument on the facts. But since respondents have made the contentions they have on the merits, we comment briefly thereon.

A. Respondents' Arguments As to Mrs. Remmey's Competence

Essentially Mrs. Remmey was, if at all, only marginally competent throughout the time frame that her account was handled by defendants, and she was totally

incompetent at the end of that time. However, Mrs. Remmey's claim in no way depends upon whether she was competent or not. Even if she had been totally competent, investment of 65% of her assets in real estate limited partnerships was clearly unsuitable and in violation of ethical dealing specified by the NASD Rules of Fair Practice, A 72-75. Defendants' counsel in the arbitration proceeding admitted as much, but sought to justify these investments by the PW broker Marks on the ground that Mrs. Remmey believed real estate limited partnerships, which would not pay out for at least ten years, were a form of estate planning. JA 181-82. A belief that these high risk partnerships, with high front end expenses, and commissions of about seven times usual New York Stock Exchange commissions, were suitable and safe for

that purpose demonstrates, in itself, a lack of competence. JA 187-94.

B. Delivery of Prospectuses

Defendants argue that Mrs. Remmey received each applicable prospectus and had knowledge of its contents. There is no way that this 82 year old woman understood the contents of prospectuses, which included hundreds of pages, on the basis of a few minutes conversation with the broker. But more than that, the Fourth Circuit is flatly incorrect (A 28-29) in its holding that the evidence was conflicting as to whether Marks sold these partnerships without delivering current prospectuses, in violation of the criminal law, 15 U.S.C. § 77e. We defy anyone to find in this record any evidence that Marks delivered current prospectuses as to at least five of the ten partnerships sold to Mrs. Remmey. The

record below is clear that he did not. JA 237-46. He didn't even testify that he did. The sale of these partnerships in violation of criminal law is a clear violation of public policy and a well recognized ground for vacating an arbitration ruling. See, e.g., Gen. Warehouseman & Helpers Local, 767 v. Standard Brands, Inc., 579 F.2d 1282, 1292-93 (5th Cir. 1978), cert. den. 441 U.S. 957 (1979).

C. Damages to the Account

Defendants argue that each of the partnerships was making regular quarterly payments to Mrs. Remmey at the time of the arbitration hearing, citing the broker's self-serving testimony to that effect, and without referring to the fact that his testimony also indicated diminished payments on the part of those partnerships even at that time. JA 171. That the

partnerships were not totally bankrupt by the time of the arbitration hearing means very little, as does the illusory argument that the Remmey account had an overall profit of $90,000 during the three years and nine months it was mismanaged by the broker Marks. This argument can be made only by giving full credit to totally unsubstantiated hearsay valuations of the real estate limited partnerships testified to by a PW employee, rather than by considering the expert testimony offered by petitioner as to the true value of the partnerships. But even taking at face value defendants' figures, the only way their argument that the account generated an overall profit of $90,000 during the broker Marks' three years and nine months tenure is to count as <u>profit</u> taxable dividends and interest of $92,025.23 paid on the investments, other than the limited

partnerships, over the time the account was mismanaged by Marks. JA 29. Surely in an account of $519,253 Mrs. Remmey was entitled to some modest income over three years and nine months. Taxable income can in no sense be deemed a profit. In any event, the measure of damages is the difference between what this account produced and what a well managed account would have produced. See Miley v. Oppenheimer, 637 F.2d 318 (5th Cir. 1981). In this case that amount was a loss of $213,043 on the funds placed in the limited partnerships alone, even using PW's highly inflated contentions as to residual values of the limited partnerships. A 200.

The evils involved in the sale of these products by PaineWebber has belatedly been recognized by the SEC. SEC is now investigating PW for sales of these

limited partnerships and others between 1980 and 1992, and class actions seeking recovery will undoubtedly be instituted. Wall Street Journal, November 22, 1994. Unfortunately, because of the Fourth Circuit failure to oversee and reverse the gross violations of arbitration due process here involved, Mrs. Remmey's valid claims will be barred by res judicata in any forum, hardly a result likely to bolster public confidence in arbitration. Such confidence is currently at an all time low. See Can't Get No Satisfaction. Wall Street: Customers With Complaints Are Fed Up With the Arbitration System. So Are Their Brokers., Newsweek, August 29, 1994, p. 45.

It should also be noted that a class action, SEC v. Prudential Securities, Inc., 1993 CCH Fed. Sec. L. Rep. Transfer Binder, ¶ 97,780, was recently concluded upon an open-ended settlement of

$330,000,000 (recently increased by $330,000,000) to be paid by Prudential for claims arising out of the sale of products similar to those sold by PaineWebber to Mrs. Remmey in this case.

CONCLUSION

While review of the merits of arbitration decisions may be limited, there is no doubt that this Court requires of the lower federal courts supervision of the arbitration process system "sufficient to insure that arbitrators comply with the requirements of the [securities] statute." Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 232 (1987). This petition for certiorari involves clear systemic defects in arbitral due process in a securities matter. The case cries out for rulings by this Court which will clarify the duties of the lower federal

courts in this area of the law where public confidence has been so eroded.

Respectfully submitted,

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